Community-based Economic Development Revolving Loan Fund Operating and Administrative Plan

Business Development and Support Division
Department of Business, Economic Development and Tourism
State of Hawaii
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CBED
Community-Based Economic Development

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PART ONE: REVOLVING LOAN FUND STRATEGY

1. Economic Adjustment Overview

1.1 Nature and Scale of Economic Adjustment

The economy of the State of Hawaii in 2019 had a combined gross regional product from the four counties of approximately $97.3 billion [source: BEA] and net imports of $3.8 billion [source: WISER] and net exports of $446.7 million [source: WISER]. The State's economy supports approximately 934,647 jobs [source: EMSI] that pay an average of $57,761[source: EMSI] in annual earnings. The COVID19 pandemic and the concomitant efforts to control its spread in Hawaii in the first and second quarters of 2020 have severely impacted the state's tourism industry, which directly and indirectly accounts for about a third of the state's gross regional product. Subsequently, the state's unemployment rate went from one of the lowest in the U.S. to one of the highest in a matter of a couple months. According to the U.S. Bureau of Labor Statistics (BLS) in May 2020 Hawaii had the second highest unemployment rate in the country at 22.6%, just behind Nevada. Kahului, Maui saw the country's largest over-the-year unemployment rate increase in April, shooting up to 35% according to the BLS.

Economic developers in Hawaii think generally in terms of three broad categories of the state's economy: tourism, the defense industry, and then everything else including agricultural, manufacturing and the innovation industries. From a statistical point of view various percentages of NAIS codes data can be allocated to these three broad categories. This revolving loan fund plan mostly concerns itself with growing the third category, which supports the state's long-terms goals of a *sustainable and more diverse economy* with less dependence on tourism, which has made the state very vulnerable to economic shocks from outside the state as we have seen with the COVID19 pandemic.

The 2016-2020 Hawaii Statewide Comprehensive Economic Development Strategy (CEDS) captures the foundational economic planning activities for the State of Hawaii and draws on the existing state statutory and planning framework. Isolated from the rest of the world, Hawaii is highly dependent on imports and therefore extremely vulnerable to outside economic and environmental disturbances. During the Special Session of 2005, the Hawaii State Legislature established the Hawaii 2050 task force. Its context was the desire of the citizenry to have a vibrant, diversified economy; a healthy quality of life that is grounded in a multi-ethnic culture and host culture values and healthy natural resources. In 2011, the Hawaii State Legislature amended the Hawaii State Plan to establish priority guidelines and principles to promote sustainability, HRS Sec. 226-108, as follows:

- Encouraging balanced economic, social, community, and environmental priorities;
- Encouraging planning that respects and promotes living within the natural resources and limits of the State;
- Promoting a diversified and dynamic economy;
- Encouraging respect for the host culture;
- Promoting decisions based on meeting the needs of the present without compromising the needs of future generations;
- Considering the principles of the ahupua‘a system; and
- Emphasizing that everyone, including individuals, families, communities, businesses, and government, has the responsibility for achieving a sustainable Hawaii.

1.2 Strategies to Deal with Economic Adjustment

Targeted clusters were identified through the CEDS formulation process and included review of public policy documents and input from government, stakeholder and community groups. Statewide targeted clusters are:

1. Hospitality and Tourism
2. National Security
3. Health Care
4. Research, Innovation, and Technology
5. Agriculture and Food Production
6. Energy
7. Manufacturing
8. Creative Industries

The Community-based Economic Development (CBED) Revolving Loan Fund (RLF) resides in the State of Hawaii’s Department of Business, Economic Development and Tourism (DBEDT), which is Hawaii’s state-wide economic development organization. DBEDT’s mission is to promote a Hawaii economy that embraces innovation and is globally competitive, dynamic and productive, providing opportunities for all Hawaii’s citizens. Through DBEDT’s attached agencies, the Department also fosters planned community development, creates affordable workforce housing units in high-quality living environments, and promotes innovation sector job growth.

The CEDS analysis identified Hawaii’s internal strengths and weaknesses as well as the opportunities and threats for driving and mitigating economic growth in today’s dynamic, fast-paced and correlated global markets. The ability of the state to be more resilient to economic shocks is a key goal. The CBED RLF is a state-wide loan program not limited to an industry sector. However, given the above *resiliency* goal, the CBED RLF program focuses on the two CEDS clusters of: 1) Agricultural and Food Production; and 2) Manufacturing.

Currently the state food imports are roughly $2 billion per year, mostly from the US mainland. Hawaii farms produce roughly 20 percent of the state's food supply in terms of monetary value. Manufacturers, not just of value-added food products, but also of a broad range of products from packaging to apparel to giftware are critical for the state’s export markets. Both these industry clusters play an important role in the state’s economic development strategy. Through low interest loans and technical assistance, and in collaboration with other state and federal programs, the CBED RLF’s goal is to grow and make these industry clusters competitive and assist the state in transitioning to a *more sustainable and diversified economy*.

1.2.1 Agriculture and Food Production

From the CEDS the goal of this industry cluster is: *Diversified agriculture and value-added products flourish as vital components of Hawaii’s economy.*

Agriculture and Food Production in the State of Hawaii consists of five (5) industry clusters including Agricultural Inputs, Food Processing, Livestock Processing, Forestry, and Fishing and Fish products. In 2015, these 5 clusters employed a total of 22,305 jobs that paid a weighted average earning (weighted by the number of jobs per cluster contributing to the total jobs in all five clusters) of $34,757.46. From 2016 to 2020, jobs are forecast to grow at a rate of 3.3%, faster than the nation job growth forecast of 1.3%. This cluster has approximately 673 payrolled business locations in Hawaii with a job multiplier 3.00.

Objectives and Action Plans

Objective: Expand market reach of local producers to institutions and the military

Action: a) Align existing and new policies and procedures; b) Assist farmers and retailers to achieve food safety certification.

Objective: Increase access to agricultural lands with affordable, long-term leases and necessary infrastructure

Action: a) Increase the number of agriculture parks; b) Maintain and repair state agriculture irrigation systems.

Objective: Grow the next generation of farmers and entrepreneurs in agriculture, aquaculture and mariculture

Action: a) Expand outreach and technical and business assistance; b) Create incubator/ accelerator sites and programs for emerging farmers and entrepreneurs; c) Create and strengthen agriculture, aquaculture and mariculture entrepreneurial pathways in schools and in organizations serving youth; d) Support food trucks, farmers markets, agri-tourism, aqua-tourism and other forms of entrepreneurism; e) Create greater awareness of the agriculture, aquaculture, and mariculture career fields; f) Develop partnerships between industry and academia to recruit and prepare students for a career in agriculture, aquaculture, and mariculture.

Objective: Develop meaningful forums for listening and sharing with the community on agriculture, aquaculture, and mariculture entrepreneurships

Action: a) Conduct community engagement to capture the values, concerns and priorities of agriculture, aquaculture, and mariculture as industries; b) Regularly inform the community about the changing landscape of agriculture, aquaculture, and mariculture; c) Promoting understanding of science and economics of agriculture, aquaculture, and mariculture; d) Convene a millennial conference on the future of agriculture, aquaculture, and mariculture.

Objective: Support pest prevention, control and management

Action: a) Increase number of agriculture inspectors; b) Increase funding for these initiatives; c) Conduct research on most effective technology and practices.

Objective: Invest in and subsidize infrastructure to revitalize agriculture, aquaculture, and mariculture

Action: a) Use technology to enable more affordable practices; b) Increase number of and access to processing, handling and production facilities; c) Increase number of and access to livestock slaughtering, processing, and finishing facilities; d) Explore program to share resources among farmers; e) Encourage efficient distribution systems to move food to market including food incubators and food hubs.

Objective: Increase demand for, supply of and access to locally grown foods

Action: a) Expand and improve branding and labeling programs to identify local foods; b) Support consumer education programs to help consumers know local farms and farmers.

1.2.2 Manufacturing

From CEDS the goal of this industry cluster is: *Products developed in Hawaii achieve commercialization and export capability through supporting infrastructure and programs.*

Hawaii's manufacturing industry consists of 935 businesses with payroll located in the State of Hawaii. In 2015, these businesses have a total of 18,722 jobs which are forecast to grow at a rate of 6.3% between 2016-2020 which is higher than the national projected job decline of -1.6%. The manufacturing industry in Hawaii pays average annual wages of $49,493 per job.

This cluster has approximately 929 payrolled business in Hawaii with a jobs multiplier of 3.00.

Objectives and Action Plans

Objective: Increase the number of and foster stronger partnerships between Small Business Innovation Research (SBIR) companies and federal lab with the intention of bringing more resources and knowledge to technology and manufacturing companies in Hawaii

Action: a) Support programs that cover the entrepreneurial aspects of manufacturing; b) Support and create initiatives such as the Hawaii on the Hill Initiative to provide national exposure to manufacturers of Hawaii products.

Objective: Focus on revenue growth by expanding into new markets for Hawaii's manufacturers and technology companies locally, nationally and internationally to be more globally competitive

Action: a) Continue to work with the Chamber of Commerce of Hawaii in a coordinate manner through the Manufacturing in Hawaii Group on increases the voice of manufacturing in Hawaii; b) Evaluate and assess barriers to markets outside of Hawaii and develop strategies to support innovative solutions and actions to address the barriers, i.e. Jones Act, Land Use Policies, and

Tax Reform affecting manufacturers; c) Provide support for manufacturers with a focus on prototyping and 3-d printing.

Objective: Gain efficiencies for Hawaii's manufacturing, reducing cost, increasing workforce competency. Achieve production efficiency through Lean Six Sigma training, energy efficiency, programmable logic controls and systems training.

Action: a) Work with the appropriate organizations as well as private education providers on the training Hawaii's manufacturing workforce by leveraging both federal and state training programs such as the Manufacturing Extension Partnership: b) Develop a system of engagement between the education, research, development, training and manufacturing stakeholders to solve problems faced in the manufacturing industry.

1.3 CBED Revolving Loan Fund to Support Economic Adjustment Activities

The Hawaii Alliance for Community-Based Economic Development (HACBED) is a nonprofit organization established in 1989 by a group of community development practitioners. HACBED formulated strategies for the state government to support community-based organizations (CBOs) that wanted to create economic development initiatives. These efforts resulted in program legislation to provide financial and technical assistance to local groups. The Legislature created a Community-Based Economic Development (CBED) Program in the Department of Business, Economic Development and Tourism (DBEDT) with Act 111, SLH 1991, codified as Chapter 210D, Hawaii Revised Statutes. The purpose of the CBED Program by statute is an acknowledgement that:

(1) It is in the best interest of the State to bring about a diversification of opportunities in all aspects of life for the residents and communities of the State;

(2) Community-based enterprises play an important part in providing a diversification of opportunities for Hawaii's residents and communities;

(3) Community-based enterprises are characterized by their interests not only in profits but in community empowerment, that is, building the community to enable it to be more self-reliant, which encourages diversification of opportunities for Hawaii's residents and communities;

(4) Community-based enterprises have the potential to increase self-determination, provide employment opportunities, strengthen community identity, retain and create community cultural

anchors, and reinforce community social, cultural, economic, and spiritual values, and are thus of crucial importance in securing the diversification of opportunities;

(5) Programs to develop community-based enterprises have the potential to increase self-reliance and provide employment opportunities to Hawaii's people;

(6) Conventional financial institutions traditionally do not provide loans to establish or expand community- based enterprises;

(7) No present state agency or program has the authority to financially assist community-based enterprises; and

(8) The State should initiate a program to assist community-based enterprises through loans and technical assistance.

The legislation created the **CBED Advisory Council** and the **CBED RLF** with an appropriation of $900,000, in 1991. Today, more than ever, Hawaii must move toward a new economy. The forces of globalization and economic transition have created great challenges in the world economy. Hawaii's isolation and dependence on tourism have made the islands more susceptible to these effects. CBED is a bottom-up economic development initiative that can supplement more centralized or top-down approaches. This bottom-up approach begins by sourcing economic development opportunities from local communities and businesses themselves. The communities can be "demographic communities" or "communities of interest." These business opportunities, which usually become projects, not only have community-backing, but usually have some form of community involvement and/or impact. The CBED approach can help build new infrastructure for a more sustainable Hawaii economy, based on decentralization, partnerships, human resource development, and innovation.

The CBED RLF was established to offer low interest loans to businesses and provide technical assistance that results in measurable community economic impact including new jobs in economically challenged areas of the state. Targeted businesses of the CBED RLF are those that would have difficulty in acquiring a loan from a commercial bank.

The CBED RLF currently has less than $300,000, having made a disbursement for a new approved loan of $60,000 last month. There are five current CBED RLF loans. Approval of an

EDA grant for the CBED RLF will allow DBEDT to expand the CBED RLF program and reach a larger number of companies with loans for business start-up, expansion and retention. Sources of revenue for the CBED RLF include repayments of loan principal, loan interest, and "transfers" of general funds from DBEDT.

Since the CBED RLF is not large, creating and leveraging partnerships and spreading risk has been a crucial aspect of the program's success. Currently, the CBED Program does co-lending with another state government department and also more recently with a non-profit, both with complementary missions. DBEDT has Memoranda of Agreement for co-lending with:

- Hawaii Department of Agriculture's Agricultural Loan Division and
- Feed the Hunger Foundation Loan Program.

Additionally, the CBED Program partners with other state, federal and private agencies to provide technical assistance and help build the capacity of small businesses, entrepreneurs, and community-based organizations through training workshops, conferences, conventions, and other events.

2. Business Development Strategy

2.1 Objectives

The objectives of the business development strategy for the CBED RLF is to:

1) to support certain types of business activities as outlined in the CEDs; in particular, manufacturing; the diversification of agriculture and value-added agricultural production and

2) to grow jobs in economically challenged areas of the state. CBED loans can be used for: start-up costs and working capital; construction or improvement of facilities; purchase of equipment; payment of production and marketing expenses including materials, labor and services.

Since this is community-based economic development, the program looks for how loans can further community linkages such as more local sourcing of product inputs and/or an increase in local employees as a result of business expansions.

2.2 Targeted Businesses

The CBED RLF targets businesses in the sectors that are in the State's CEDS plan and more specifically business that are or have been part of the State's Enterprise Zone (EZ) Program, which is predominantly comprised of manufacturers and value-added agricultural companies. By definition, Enterprise Zones are economically challenged areas of the state and can only qualify based on census tract data. More recently, the CBED Program has been engaged with businesses located in the state's Opportunity Zones (OZs) [see maps of EZs and OZs in attachments].

In a strategy session held to refresh the CBED Program, the CBED Advisory Council listed the following as desired program goals:

Create jobs & opportunities (such as new businesses) in economically disadvantaged areas and empower communities to control their own economic destiny by:

1) Targeting communities in disadvantaged areas of the state such as those located in Enterprise Zones (EZ);
2) Supporting start-ups, business expansions, social enterprises, co-ops, and entrepreneurship;
3) Considering youth training and mentorship/apprentice programs in projects;
4) Facilitating sustainability among communities and organizations so they can continue operating;
5) Including multiple communities – by demographic, by island;
6) Leveraging program funds through partnerships;
7) Dovetailing CBED program with EZ and other state, county, federal, private programs;
8) Seeking ways CBED can uniquely impact, not replicate, what others are doing. The Council also noted that while specific industries should not be targeted or given preference, the CBED program should consider which industries will create the most jobs and jobs requiring skilled workers.

2.3 Business Needs

Our targeted businesses need expansion capital and they are usually not able to qualify for a conventional loan from a commercial bank. Loans aim to address the business needs of start-up costs and working capital; construction or improvement of facilities; purchase of equipment; and payment of production and marketing expenses including materials, labor and services. Another business need that the CBED Program addresses is technical assistance, particularly as regards scaling up a business from an operational and manufacturing perspective. Lastly, DBEDT assists companies on business development, particularly for the mainland US market and foreign markets such as Japan.

2.4 Other Programs and Activities

The Enterprise Zone Program gives State & County benefits to certain types of companies in an effort to stimulate business activity, preserve and create jobs in areas where they are most appropriate or most needed. Businesses that satisfy annual hiring requirements qualify for State tax benefits for up to seven consecutive years. Businesses in the following sectors are eligible for this program: Agricultural production or processing; Manufacturing; Wholesaling /Distribution; Aviation or maritime repair or maintenance; Telecommunications switching and delivery systems; Information technology design and production; Medical research and clinical trials; For-profit training programs in international business management or environmental remediation; Biotechnology research, development, production, or sales; Repair or maintenance of assisted technology equipment; Certain types of call centers and Wind energy producers.

Since the early 1990's well over 1,000 eligible Hawaii companies have participated in the EZ Program. In 2018 EZ companies eligible to receive EZ benefits reported 3,835 new or maintained jobs statewide, an increase of over 100% from the 1,746 jobs reported in 2017. The business activities that reported the greatest number of jobs in the EZ Program in 2018 were, in order: 1) Agricultural Production or Processing; 2) Wholesaling; and 3) Manufacturing. The average size of companies participating in this program in 2018 was 34 employees and $4,678,306 in revenue. Many of these EZ companies have usually been in need of expansion capital at some point and the EZ Program has been a pool from which many of the CBED RLF borrowers have come. The CBED program normally targets the smaller companies with fewer than 20 employees within the EZ Program, particularly those businesses that would most likely not be able to get a conventional loan from a commercial bank for expansion.

Hawaii designated 25 census tracts as Opportunity Zones as part of the new federal community development program established by Congress in the Tax Cuts and Jobs Act of 2017 to encourage long-term investments in low-income urban and rural communities nationwide. This initiative provides incentives for investors to re-invest realized capital gains into Opportunity Funds in exchange for temporary tax deferral and other tax relief benefits. The Opportunity Funds are then used to provide investment capital in certain low-income communities, i.e., Opportunity Zones. Its stated purpose is to encourage entrepreneurship and expansion capital for economically distressed areas of the country. As part of the program equity investments can be made in companies within the Opportunity Zones. DBEDT looks to support this type of investment with CBED RLF loans as part of the overall financing package for the revitalization of businesses within Hawaii's Opportunity Zones.

All the Opportunity Zones in Hawaii overlay with other economic development initiatives such as New Market Tax Credits, Enterprise Zones and Transit Orient Development (TOD) Zones. There are also many other non-census tract-based programs that can be applied to CBED RLF clients, such as the State's Manufacturer's Assistance Program (MAP), which offers Hawaii-based manufacturers up to a 20% reimbursement (up to $100,000) on qualified expenses to help Hawaii manufacturers become globally competitive. Qualifying expenses include: equipment purchases, training, energy efficiency projects, and manufacturing feasibility studies. In 2019 alone, 37 companies received MAP funding for capital equipment purchases and upgrades.

3. Financing Strategy

3.1 Financing Needs

From the Small Business Credit Survey from the Federal Reserve Bank, San Francisco [Source: Small Business Credit Survey Federal Reserve Bank, San Francisco published November 2017 page 16], years before the current COVID19 economic disaster Hawaii firms were already facing some financial difficulties:

• While most Hawaii firms had not been increasing their debts, 73 percent of firms possessed outstanding debt, roughly on par with the national average.

• Of firms with prior outstanding debt, nearly 40 percent of them have debts amounting to more than $100,000.
• More than 61 percent of firms did not apply for funds. Of those that did not apply, 45 percent chose not to apply because they were sufficiently financed.
• *A quarter of businesses did not apply for financing out of fear of being turned down*, and another quarter did not apply because they were debt averse.
• The three most cited financial challenges experienced in 2016 were debt payments, operating expenses, and a lack of credit availability.
• While most firms that applied for funding cited expansion of business as a primary reason, addressing operating expenses comprised a significant reason to seek financing.
• *Most applicants sought out funding for less than $100,000 (nearly 62 percent of applicants, compared to 55 percent nationally).*
• Loans and lines of credit were the dominant financing products. Nearly 94 percent of applicants applied for a loan or line of credit; 35 percent applied for a credit card.
• Firms sought out both large banks (50 percent) and small banks (52 percent), with few seeking online lenders (12 percent). *Only 1 percent of firms applied for funding from CDFIs, which was significantly lower than the national rate of 6 percent.*

3.2 Local Capital Market

None of the major national banks (e.g. Bank of America, Chase, Wells Fargo) have any branches in Hawaii. Between high rents for commercial space, a small market, and deeply entrenched local competition, it's not worthwhile for them to set up shop in Hawaii. The State's six largest banks — and eight of the top 10 — are local banks. Combined, the top four control more than 90 percent of the market share. First Hawaiian Bank (Nasdaq: FHB) is the state's largest bank with a little over a third of the market share and local deposits of $16.5 billion in 2019. Bank of Hawaii (NYSE: BOH), the second-largest bank, had a little less than a third of the market share, and local deposits of $15.8 billion in 2019. The No. 3 bank, American Savings Bank, had over 13 percent of the market share and local deposits of $6.3 billion in 2019. The fourth-largest, Central Pacific Bank (NYSE: CPF), had over 10 percent of the market share and local deposits of $5.1 billion in 2019. [Source: Hawaii Banker's Association, Pacific Business News]

Hawaii has 13 Community Development Financial Institutions (CDFI), which are specialized community-based financial institutions with a primary mission to promote economic development by providing financial products and services to people and communities underserved by traditional financial institutions, particularly in low income communities. CDFIs include community development banks and credit unions, and non-regulated institutions such as non-profit loan funds or venture capital funds. Most CDFIs in Hawaii are undercapitalized and not very active in making loans to small businesses. The CDFIs in Hawaii are: Big Island Federal Credit Union; Independent Employers FCU; Aloha Federal Credit Union; Hawaii Community Reinvestment Corporation; Hawaii Federal Credit Union; HawaiiUSA Federal Credit Union; HHOC Mortgage; Prince Kuhio Federal Credit Union; The Queens Federal Credit Union; Hawaii First FCU; Lei Ho'olah; Council for Native Hawaiian Advancement; Molokai Community Federal Credit Union. *There were only 14 originations from CDFIs in Hawaii totaling $3.3 million to businesses* and 61 originations totaling $14.1 million to individuals in 2017. [Source: Coalition of Community Development Financial Institutions (CDFI Coalition)]

3.3 RLF Financing Niche

The CBED RLF loans are intended to be small usually $25,000 to $100,000 and when co-lending CBED usually puts in $25,000 to $50,000 and the co-lending partner will put in an equal amount for a total of $50,000 to $100,000. These loans are used when no other sources of lending are available to the business. Potential borrowers are first required to try a commercial lender and only if they cannot qualify for a conventional loan can they apply to the CBED RLF. The primary purpose of the CBED RLF is to assist in the creation and/or retention of private sector jobs resulting from small business development, including the start-up or expansion of locally owned businesses; retention of existing commercial, manufacturing, agriculture and service industries jobs; modernization and rehabilitation of existing manufacturing facilities; support for the use of new technologies applied to existing industries and growth industries and lastly, the development of businesses owned and operated by economically challenged communities.

4. Financing Policies

4.1 Eligible Lending Area

The Legislature created the Community-Based Economic Development (CBED) Program in 1991 in the Department of Business, Economic Development and Tourism (DBEDT) with Act 111, SLH, 1991, codified as Chapter 210D, Hawaii Revised Statutes. The CBED Advisory Council and the CBED Revolving Fund were also created.

The CBED Revolving Fund may make loans throughout the State of Hawaii. Loans may be made to any business whose activities benefit the community in which it is located. However, preference for loan funding would extend to businesses located in Hawaii Opportunity Zones and Hawaii Enterprise Zones.

4.2 Allowable Borrowers

To be eligible for a loan, the applicant shall:

(1) Be an organization engaged in or establishing community-based economic development activities or a community-based enterprise;

(2) Not be able to obtain a loan from at least one (1) private or public financial institution;

(3) Furnish information to show that the applicant has the ability to repay the loan out of income from the business;

(4) Have applied for or received all applicable licenses and permits;

(5) Satisfactorily demonstrate to the department that it can operate on a sound financial basis;

(6) If required by the department, provide collateral to reasonably protect the State's interest.

(7) Demonstrate that the purpose of the loan is in conformity with provisions of Chapter 15-120, Hawaii Administrative Rules; and

(8) Demonstrate that the loan amount is not obtainable:

- (A) Through other existing state loan program;
- (B) Through the public offering or private placement of securities of the applicant;
- (C) Through the disposal at fair price of assets not required by the applicant in the conduct of its existing business or not reasonably necessary to its potential healthy growth;

(D) Without undue hardship through utilization of the personal credit or resources of the owner, partners, management, or principal shareholders of the applicant; or

(E) Through other appropriate government financing.

4.3 Allowable Lending Activities

Primary business activities for loans include, but are not limited to, those listed in the CEDS with particular emphasis on (1) Agricultural Production or Processing; (2) Manufacturing; (3) Wholesaling businesses.

Prohibited uses:

Loans shall not be made where the direct or indirect purpose or result would be to:

(1) Pay off a creditor or creditors of the applicant who are inadequately secured and are in a position to sustain a loss;

(2) Provide funds, directly or indirectly, for payment, distribution, or as a loan to owners, partners, or shareholders of the applicant's business, except as ordinary compensation for services rendered;

(3) Effect a change in ownership of a business, unless the change shall promote the sound development or preserve the existence of the business;

(4) Provide or free funds for speculation in any kind of property, real or personal, tangible or intangible;

(5) Provide funds to an applicant to engage in the business of lending or investing money;

(6) Finance the acquisition, construction, improvement, or operation of real property which is to be held primarily for sale or investment; provided that this prohibition shall not apply to a loan for the remodeling, maintenance, or improvement (including expansion) of existing commercial or industrial structures already held by the applicant for rental or for use as an essential part of an ongoing business; or

(7) Encourage monopoly or be inconsistent with generally accepted practices of the American system of free enterprise.

Additionally, per EDA RLF rules, borrowers cannot:

1. Use the RLF to acquire an equity position in a private business (i.e., equity financing);
2. Subsidize interest payments on an existing RLF Loan;

3. Provide a loan to a borrower for the purpose of meeting the requirements of equity contributions under another Federal agency's loan program;
4. Enable a borrower to acquire an interest in a business, either through the purchase of stock or the acquisition of assets, unless sufficient justification is provided in the loan documentation. Sufficient documentation may include acquiring a business to save it from imminent closure or to acquire a business to facilitate a significant expansion or increase in investment with a significant increase in jobs. The potential economic benefits must be clearly consistent with the strategic objectives of the RLF;
5. Provide funds to a borrower for the purpose of investing in interest-bearing accounts, certificates of deposit, or any investment unrelated to the objectives of the RLF;
6. Refinance existing debt, unless:
    a. You sufficiently demonstrate in the loan documentation a "sound economic justification" for the refinancing (e.g., the refinancing will support additional capital investment intended to increase business activities). For this purpose, reducing the risk of loss to an existing lender(s) or lowering the cost of financing to a borrower shall not, without other indicia, constitute a sound economic justification; or
    b. RLF funds will finance the purchase of the rights of a prior lien holder during a foreclosure action which is necessary to preclude a significant loss on an RLF loan. RLF funds may be used for this purpose only if there is a high probability of receiving compensation from the sale of assets sufficient to cover an RLF's costs plus a reasonable portion of the outstanding RLF loan within a reasonable time frame approved by EDA following the date of refinancing.
7. Serve as collateral to obtain credit or any other type of financing without EDA's prior written approval (e.g., loan guarantees);
8. Support operations or administration of the RLF recipient;
9. Undertake any activity that would violate EDA Property regulations found at 13 CFR part 314;
10. Finance gambling activity, performances or products of a prurient sexual nature, or any illegal activity, including the cultivation, distribution, or sale of marijuana that is illegal under Federal law.

11. Use the RLF to induce the relocation of existing jobs within the U.S. that are located outside of Recipient's jurisdiction to within its jurisdiction in competition with other U.S. jurisdictions for those same jobs.

4.4 Loan size

The amount of the outstanding balance on all loans to any one applicant at any one time shall not exceed $250,000.

5.5 Interest Rates

Each loan shall bear a simple interest rate of not less than three (3) and not more than six (6) percent a year.

4.6 Terms

Loans may be granted for up to ten (10) years.

4.7 Fees

No fees are charged to borrowers.

4.8 Equity & Collateral

The DBEDT Director shall determine the amount and kind of security required for each loan. Such security may be subordinated to other direct loans made by financial institutions.

4.9 Moratoria

The DBEDT Director shall determine the commencement date for the repayment of the first installment. The director may defer the first installment on the principal and interest of each loan for a period not to exceed two (2) years.

4.10 Start-Ups

No difference in policies for loans to start-ups (new businesses) versus loans for retention or expansion of an established business.

4.11 Working Capital

Working capital loans are allowed.

4.12 Credit not otherwise available

Borrower must demonstrate that the loan amount is not obtainable:

(A) Through other existing state loan program;

(B) Through the public offering or private placement of securities of the applicant;

(C) Through the disposal at fair price of assets not required by the applicant in the conduct of its existing business or not reasonably necessary to its potential healthy growth;

(D) Without undue hardship through utilization of the personal credit or resources of the owner, partners, management, or principal shareholders of the applicant; or

(E) Through other appropriate government financing.

5. Portfolio Standards and Targets

5.1 Target percentages

The following is the targeted percentage breakdown of borrowers for the CBED RLF. It is anticipated that the breakdown of borrowers by percentage of dollar amount is as follows:

- Public/Private (Ownership): 0/100
- Fixed Asset/Working Capital: 40/60
- Start-Up/Expansion/Retention: 10/60/30
- Locally owned/Outside owned: 100/0
- Manufacturing/Value-added Agricultural/Other: 35/40/25

5.2 Leverage

The CBED RLF will follow the EDA required minimum ratio of two dollars in private investment for every one dollar of RLF loans as applied to the whole portfolio (not individual loans) as identified in 13 CFR 307.15(d). Private investment may include (1) capital invested by the borrower or others; and (2) financing from private entities; (3) The non-guaranteed portions and 90 percent of the guaranteed portions of any Federal loan; or (4) loans from other state and local lending programs. Projects that provide higher private investment will receive consideration over those providing lower investment, all other factors (such as job creation) being equal.

5.3 Cost/Job Ratio and Types of Jobs

The CBED RLF's target job/cost ratio is one job created or retained per every $25,000 of proceeds used. Applicants with a lower investment per job will be given priority over larger investments per job. The CBED RLF will concentrate on creating family-wage employment, primarily for low and moderate income families. Skilled and semi-skilled jobs will be viewed as those most desirable for long-term employment.

6. RLF Loan Selection Criteria

The CBED RLF loan selection will be based on the financing policies and portfolio standards discussed earlier in this document particularly around the CEDS strategy, which capitalizes on regional assets and be consistent with 13 CFR 307.17(a). Proposed projects that can demonstrate the following criteria will take priority when awarding loans:

- Businesses locally owned and operated
- Businesses which can show positive community economic benefits as a result of the loan
- Businesses that maximize private investment that would otherwise not come to fruition without the CBED RLF loan
- Employment gains as a result of the loan and particularly of higher skill and higher wage jobs
- Projects that show innovation, increased productivity and thus strong potential future growth
- Projects which complement or provide linkages with other firms in the area (supply chain)
- Borrowers willing to retrain and upgrade unskilled, semi-skilled, or displaced workers.

7. Performance Assessment Process

The CBED RLF will be evaluated on a semi-annual basis in conjunction with the reporting to the Economic Development Administration (EDA) by the CBED Program staff. A review of the loan portfolio will also be made available to the CBED Advisory Council at each meeting in which a loan is being discussed or issued. Success metrics of the loan portfolio will be tracked in accordance with EDA regulations and the CBED RLF strategy.

The CBED RLF will update its management plan in accordance with 13 CFR 307.9. At a minimum the plan will be updated every five years. Notification will be given to the Economic Development Administration of any changes made to the plan as well as any changes that affect the RLF. DBEDT can choose to update the CBED RLF management plan sooner than every five years as the Department sees fit.

PART TWO: RLF OPERATIONAL PROCEDURES

The Hawaii State Legislature created a Community-Based Economic Development (CBED) Program in the Department of Business, Economic Development and Tourism (DBEDT) and this was codified as Chapter 210D, Hawaii Revised Statutes. The legislation created the **CBED Advisory Council** and the **CBED Revolving Loan Fund** in 1991. The statute and the concomitant administration rules are the primary governing documents for the CBED program including the CBED Revolving Loan Fund.

8. Organization Structure

8.1 Critical Operational Functions

The CBED RLF Program is administered through the Department of Business, Economic Development and Tourism (DBEDT), which is the State of Hawaii's economic development agency. DBEDT markets the CBED RLF Program through the use of collateral materials, the CBED website, industry-specific speaking engagements, information booths at small business fairs and similar outreach venues. Additionally, the CBED RLF Program will work in collaboration with partner organizations to market and implement the Program including, but not limited to:

- Small Business Administration (SBA)
- Small Business Development Centers (SBDC) (business advisory partner)
- Innovate Hawaii (Hawaii's Manufacturing Extension Partnership (MEP))
- Hawaii Department of Agriculture and Feed the Hunger Foundation (co-lending partners)
- Hawaii Farm Bureau
- County governments and other federal government departments
- Patsy T. Mink Center for Business and Leadership

The above organizations along with DBEDT will also provide business assistance and advisory services to prospective and actual borrowers. They will also assist with regulatory compliance assurance.

Either DBEDT or one of the CBED RLF co-lending partners handle loan processing including reviewing applications, conducting credit analysis, preparing loan write-ups and presentations to the CBED Advisory Council for their loan recommendations. Either DBEDT or one of the CBED RLF co-lending partners handle the loan closings.

Loan Servicing (administrating loan collections, defaulted loans) will be handled by DBEDT, a co-lending partner or a third-party contractor. In the latter case state procurement rules would be employed to contract for this service. Foreclosures will be handled by the State Department of the Attorney General.

Financial record-keeping and ensuring compliance with EDA requirements will be administered by DBEDT.

8.2 Loan Administration Board

The CBED Advisory Council consists of 10 members. The Director of DBEDT, the Chairperson of the State Board of Agriculture, and the Chairperson of the Office of Hawaiian Affairs, or their respective designees, are ex-officio members. The Governor appoints the remaining seven members, representing all counties plus one member who has specific commercial finance experience. <u>The Council reviews CBED financing requests and makes recommendations on loans subject to the final approval of the DBEDT Director.</u> The Council also advises the director on program implementation, and members represent their island/county in liaison with community-based organizations.

Council members bring a myriad of skills sets to the Department and the CBED Program. Skill sets of current CBED Advisory Council Members include, but are not limited to: Strategic Communications, Program Management, Community Outreach, Project Management, Government, Strategic Planning, Public Speaking, Nonprofits, Leadership, Business Strategy/Business Analytics, Financial Modeling, Process Improvement, Finance, Risk Management, Public Policy, Grants, Public Administration, Customer Service, Legislative Relations, and Policy Analysis.

Membership Terms: Ex-Officio members or their agency representatives hold life-time Advisory Council positions. Members, representing their respective counties who are nominated by the Governor and confirmed by the State Legislature – Senate Economic Development Committee, are appointed for an initial four (4) year term and may serve a second four (4) year term, but not more than eight (8) years.

Quorum requirements: A quorum of 60% of the total Advisory Council members is required for a formal CBED Advisory Council meeting.

8.3 Conflicts of Interest

The CBED RLF will be governed by 13 CFR § 302.17, the EDA's Conflicts of interest federal regulation, which states:

(a) General. It is EDA's and the Department's policy to maintain the highest standards of conduct to prevent conflicts of interest in connection with the award of Investment Assistance or its use for reimbursement or payment of costs (e.g., procurement of goods or services) by or to the Recipient. A conflict of interest generally exists when an Interested Party participates in a matter that has a direct and predictable effect on the Interested Party's personal or financial interests. A conflict also may exist where there is an appearance that an Interested Party's objectivity in performing his or her responsibilities under the Project is impaired. For example, an appearance of impairment of objectivity may result from an organizational conflict where, because of other activities or relationships with other persons or entities, an Interested Party is unable to render impartial assistance, services or advice to the Recipient, a participant in the Project or to the Federal government. Additionally, a conflict of interest may result from non-financial gain to an Interested Party, such as benefit to reputation or prestige in a professional field.

(b) Prohibition on direct or indirect financial or personal benefits.

(1) An Interested Party shall not receive any direct or indirect financial or personal benefits in connection with the award of Investment Assistance or its use for payment or reimbursement of costs by or to the Recipient.
(2) An Interested Party also shall not, directly or indirectly, solicit or accept any gift, gratuity, favor, entertainment or other benefit having monetary value, for himself or herself or for another person or entity, from any person or organization which has obtained or seeks to obtain Investment Assistance from EDA.
(3) Costs incurred in violation of any conflicts of interest rules contained in this chapter or in violation of any assurances by the Recipient may be denied reimbursement.
(4) See § 315.15 of this chapter for special conflicts of interest rules for Trade Adjustment Assistance Investments.
(c) Special rules for Revolving Loan Fund ("RLF") Grants. In addition to the rules set forth in this section:
(1) An Interested Party of a Recipient of an RLF Grant shall not receive, directly or indirectly, any personal or financial benefits resulting from the disbursement of RLF loans;
(2) A Recipient of an RLF Grant shall not lend RLF funds to an Interested Party; and
(3) Former board members of a Recipient of an RLF Grant and members of his or her Immediate Family shall not receive a loan from such RLF for a period of two years from the date that the board member last served on the RLF's board of directors.

Additionally, CBED staff and CBED Advisory Council members must abide by the State Ethics Code, Chapter 84, Hawaii Revised Statutes ("HRS") which directs CBED staff and the CBED Advisory Council to disqualify themselves from taking any official action directly affecting a business or undertaking in which they have a substantial financial interest. HRS §84-14(a). "Financial interest" is an interest held by CBED staff or CBED Advisory Council members, or an interest held by a spouse, or a dependent child of theirs, and includes ownership of a business (including stocks in corporations); a creditor interest in an insolvent business; employment; real property; a loan; or directorship or officership in a business.

According to HRS §§ 84-31(b), (c), and 84-32, a charge by a person concerning an apparent violation of the State Ethics Code is a written statement, signed under oath. Individuals normally use a notary public to authenticate oaths. Charges initiated by the State Ethics Commission need not be under oath, but must be signed by three or more commissioners. The procedure for charges includes: (1) Notice to alleged violator; (2) Investigation; (3) Informal advisory opinion and/or probable cause determination; (4) Public formal hearing and decision; (5) Referral to Legislature, Governor, Chief Justice, or Attorney General for further action.

9. Loan Processing Procedures

9.1 Standard Loan Application Requirements

Checklist of items needed from prospective borrower for loan application

1) Financial Statements and Balance Sheet (Past 3-years)
2) Three years Cash Flow of income and expenses (including assumptions)
3) Aging schedules for Accounts Payables and Account Receivables
4) Personal Financial Statements (sole proprietors, major stockholders, partners and guarantors)
5) Income Tax returns (pasts three years)
6) Copy of leases or deeds to a farm or other business facilities
7) Marketing and purchase contracts
8) Letters of decline from at least (1) private lender
9) Hawaii State Tax Clearance
10) Written narrative of the business

Identifying the borrowers and business:

1) Sole Proprietorship
    a. Education and Experience
    b. Citizenship and Residency
2) Partnerships
    a. Education and Experience of partners
    b. Citizenship and Residency of partners
    c. Copy of partnership agreement
3) Corporations and Cooperatives
    a. Education and Experience of stockholders or members
    b. Citizenship and Residency of stockholders or members

c. Copy of charter or articles of incorporation with all amendments
d. Copy of bylaws properly adopted and now in force
e. List of stockholders and amount shares owned
f. List of board of directors
g. List of officers
h. Resolution to borrow

Collateral:

1) Itemized list of equipment
2) Uniform Commercial Code (UCC)
    a. Specific security amendment on new equipment
    b. Blanket security interest of business assets
3) Real Estate Collateral
    a. Copy of mortgage and lien documents

Appraisals:

1) Chattel Appraisals
    a. Loan Officer inspection of personal property for valuations and documentation
        i. Kelly Bluebook, North American Equipment Dealerships Association
2) Facility Inspection
    a. Evaluate the resources available to fulfill the requirements of the proposed plan of operation
    b. Evaluate the adequacy of accounting systems and records and counsel the applicant of any remedies
    c. Obtain information needed to complete required appraisals
    d. Determine the adequacy of existing insurance plans to ensure the loan will be collectable.
        i. Evidence of required insurances should be in place prior to loan closing and disbursement of loan proceeds. This may include hazard, life, vehicle, liability and any other insurances required by the loan conditions.

Loan Guarantee:

1) Personal Guarantees
    a. May require the personal guarantee of each officer and director, and any stockholder
    b. There may be occasions where guarantee of individuals or businesses other than the named borrower(s) will be required.
2) Secured Guaranty
    a. Pledge of collateral that may be individually owned or jointly owned
    b. Guarantee agreements by all parties having an interest therein.

9.2 Credit and Financial Analysis

Processing of Loan Applications

Approval considerations:

1) Is the applicant a sound credit risk with ability to repay the loan?
2) Is the applicant willing to carry out recommended business management practices?
3) Is there the existence of a continuing market for the commodity/product or service proposed by applicant?

Credit Verification:

1) Repayment History
2) High low credit balances outstanding
3) Repayment Terms
4) Collateral
5) Purpose
6) Date of account opening or date of loan
7) Derogatory remarks, if any
8) Liens and/or judgments, if any
9) Credit Agencies: Dunn & Bradstreet or TransUnion

Financial Analysis:

Balance Sheet

1) Amount of capital controlled by the borrower
2) Amount of asset ownership
3) Debts that may affect payment of the proposed loan
4) Amount of liquid assets that can be used to pay current expenses
5) Financial Trend

Cash Projections and Earnings

1) Cashflow analysis based on Tax Returns (past 3 years)
2) Projections based on assumptions and loan purpose
    a. 3-year monthly cashflow projection to support debt servicing
    b. Living expenses for family businesses should be considered

Management Ability

1) Character, experience and history of success in other ventures, motivation and caliber of principals

9.3 Environmental Reviews

The borrower will be required to comply with all Federal, State and local environmental laws. The CBED RLF will ensure that potential borrowers' environmental reviews and permitting are in place particularly for loans that will lead to alteration of the physical environment (i.e. construction). It is a policy of the CBED RLF to assure that proper environmental assessment of loan fund projects takes place, that adverse environmental impacts are mitigated or avoided to the extent possible. As a general rule, CBED RLF loans will not be approved for projects which will adversely impact without mitigation the following: coastal areas, floodplains, wetlands, significant historical or archeological properties, drinking water resources or non-renewable natural resources. Borrowers must be in compliance with applicable environmental laws, Executive Orders, and regulations, including but not limited to 13 CFR Part 302, the National Environmental Policy Act of 1969 and other Federal environmental mandates. When there are questions about a loan applicant's project CBED staff will coordinate with (1) the Hawaii State Department of Health, which oversees environmental compliance in the state and also (2) the appropriate County's agency responsible for project permitting. The following are procedures for environmental review of loan applications for construction projects:

(1) Determine whether a proposed project will result in a significant adverse environmental impact. Applicants may be asked to submit additional documentation as necessary to make the determination. No activity shall be financed which would result in a significant adverse environmental impact unless that impact is to be mitigated to the point of insignificance. When necessary to ensure compliance, any required mitigation shall be made part of the loan conditions.

(2) Determine whether the proposed project involves development within a floodplain as defined by EDA Directive No. 17.04 to enable the applicant to make a determination whether there is an alternative to minimize any potential adverse impacts (Executive Order 11988, as amended by Executive Order 13690).

(3) Determine whether the project will be located within or adjacent to any wetland area. The applicant may be required to provide wetland delineation information as necessary. No activity shall be financed which would result in alternation of any wetland or in any adverse impact on any wetland without consultation with the U.S. Department of the Interior Fish and Wildlife Service on applicable laws (e.g., Endangered Species Act, Migratory Bird Treaty Act) and, if applicable, a Nationwide or site-specific Section 404 Permit with the Army Corp of Engineers shall be obtained.

(4) The potential borrower should indicate any consultation with the State Historic Preservation Officer (SHPO) for each approved loan of the potential effects the proposed project may have on historic and archaeological resources prior to closing of the loan. In cases where SHPO has recommended actions or has determined an adverse impact, the loan applicant must work with the SHPO and EDA to address any issues identified before the loan is closed.

All loan applicants are required to provide information regarding whether or not there are hazardous wastes or toxic substances such as EPA listed substances (see 40 CFR 300), leaking underground storage tanks, asbestos, polychlorinated biphenyls (PCB), or other hazardous materials present on or adjacent to the affected property that have been improperly handled and have the potential to endanger public health. If deemed necessary, loan applicants may be required to perform or provide evidence of performance of a Phase I Site Assessment to identify possible sources of contamination, a Phase II Site Assessment to test soil and/or groundwater samples, and a Phase III Site Remediation involving mitigation of applicable contaminants. No activity shall be financed which involve unresolved site contamination issues. Loan applicants shall be responsible for working with the appropriate state environmental agency office to resolve any outstanding issues before any loan can be approved for the affected site.

9.4 Loan Write-up

Loan Officer presentations should use standard formats and be explicit and concise. Proper justification, financial analysis, background information, etc., as well as recommendations and conditions should be covered at submission. The following information should be included in the loan presentation:

a. Application (full legal name, date of birth, Social Security No., State ID No., Fed ID No.)
b. Eligibility (state applicable statute and how applicant qualifies)
c. Commodity & Classification (major crops and business organization)
d. Loan Request
e. Related or Contingent Liabilities
f. Loan Purpose (specify or itemize what funds are to be used for)
g. Terms
h. Security (list all)
i. Guarantors
j. Financial Statements (summarize and include analysis)
k. Sources of Repayment (cash flow summary, income assumptions, markets)
l. Background (brief summary of applicant and business)
m. Comments
n. Turndowns
o. Recommendations (include additional conditions, if any)

9.6 Procedures for Loan Approvals

Loans must first be presented to the CBED Advisory Council for recommendation. A public meeting is called, which is subject to the state's sunshine law. Council members review the loan presentation and can ask questions of the loan officer. As long as there is a quorum of 60% of the Council's membership, a Council vote is taken for a recommendation on the loan application. A simple majority vote of the Council members is needed to approve a yes recommendation on a loan application. This is recorded in the meeting's minutes which are posted on the CBED Program's website. After the Council meets, the recommendation is sent to the Director of DBEDT who then considers that recommendation and either approves or disapproves the loan application. The loan officer is then informed of the decision and any additional conditions.

10. Loan Closing and Disbursement Procedures

10.1 Loan Closing

The Loan Officer should have a thorough knowledge and understanding of all the required documents prior to the submissions of the loan for approval.

a. A detailed list of the collateral required including legal descriptions for inclusion in security instruments.
b. The preparation and completion of all security instruments including notes, mortgages, financing statement(s).
c. Preparation of other documents and agreements such as term loan agreement, assignment of income, hazardous materials agreement, guaranty, etc.
d. The explanation of terms rate of interest, mode of payment expected, the conditions of the mortgage and any other agreements.
e. All legal documents and supporting documentation will be submitted to the Office of the Attorney General for approval.

At a minimum per 13 CFR 307.11(a)(1)(ii)(H), the required documents should include:

(1) Loan application
(2) Loan agreement
(3) CBED Advisory Council minutes with the loan approval recommendation and DBEDT Director approval of the CBED RLF loan
(4) Promissory note
(5) Security agreement(s)
(6) Deed of trust or mortgage (as applicable),
(7) Agreement of prior lien holder (as applicable)
(8) A signed bank "turn-down" letter or other documentation demonstrating that credit is not otherwise available.

10.2 Loan Agreement Provisions

DBEDT will ensure that CBED RLF funds will be used as intended by following up with the applicant on a semi-annual basis in addition to reviewing any required reports from the applicant. Each loan agreement will clearly state the purpose of each loan as per 13 CFR 307.17(a). DBEDT staff will review all loan documents to ensure that the procedures in place protect and hold the Federal government harmless from and against all liabilities that the Federal government incur as a result of providing an RLF Grant to assist directly or indirectly in site preparation or construction, as well as the direct or indirect renovation or repair of any facility or site as per 13 CFR 307.10(c). DBEDT staff will review and go over all loan agreement provisions during the initial intake of application requirements and during the signing of documents for ensuring that prospective borrowers, consultants, or contractors are aware of and comply with the Federal statutory and regulatory requirements that apply to activities carried out with the RLF loans. These loan agreement provisions will also be reviewed at closing of the loan. All EDA RLF loans must include loan call stipulations for instances of non-compliance as per 13 CFR 307.10(b).

10.3 Loan Disbursement

The loan officer will have the responsibility of requesting the funds for disbursement. The loan officer should ensure that all loan proceeds are used in accordance with the loan purpose. Disbursements should not be made until confirmation of recordation has been received. Disbursements may be made directly to the borrower or can be made jointly to the borrower and a vender.

11. Loan Servicing Procedures

11.1 Repayment and Monitoring

Loan servicing by DBEDT, Co-lending Partner or Third-party Servicing Agent (All contracting and procurement completed by DBEDT will be conducted pursuant state procurement regulations):

1. Specific Loan Servicing Functions:

   (a) issue loan coupons to the borrower directing loan repayment to CBED RLF,

   (b) issue payoff demands, and mortgage ratings,

(c) demand, receive, and collect all loan payments,

(d) issue annual income tax statements to the borrower,

(e) answer borrower inquiries, demands, and requests;

(f) apply expertise in lending and loan collection to grant appropriate payment deferrals and minor extensions which do not significantly affect the maturity date of the Loan, and to negotiate short-term, temporary workout agreements upon a showing of need by the borrower, subject to the limitations on loan modifications, extensions, substitutions, assignments, or assumptions set forth in subsections (i) and (j), below,

(g) monitor and use best efforts to secure borrower compliance with required insurance coverages,

(h) make field inspections on regular basis to monitor operations and to inspect collateral,

(i) review and analyze borrower requests for major or otherwise significant substitutions and/or releases of collateral,

(j) review and analyze borrower requests for major or otherwise significant loan modifications, extensions, or assumptions, and

(k) provide monthly reports on loan status and communicate any significant factors that could detrimentally affect the Loan.

11.2 Loan Files

Loan files will be maintained as per 13 CFR 307.13. At a minimum CBED RLF loan files should include in addition to the loan application and closing documents, a copy of any private lender loan agreement, financial statements, annual insurance certifications, annual site visit reports, general correspondence and job reports. Loan files will be stored in fireproof, locked file cabinets.

11.3 Job Creation

The initial job creation claims will be reviewed and jobs will be tracked after loan approval through regular communication with the borrower. At a minimum this information will be requested on a semi-annual basis. This information will be used in reporting to the CBED

Advisory Council and DBEDT Director as well as the semi-annual reports to the Economic Development Administration.

11.4 Defaulted Loans

According to Hawaii Administrative Rules §15-120-13 regarding loans in default:

(a) Loans that are three installments in arrears shall be considered in default. The borrower shall also be considered to be in default for failure to comply with any term or condition of the loan authorization, loan agreement, or mortgage. If the borrower is in default, then at the option of the DBEDT Director, the entire balance plus accrued interest shall become due and payable. The DBEDT Director may foreclose any mortgage by any method provided by law. Any expense incurred by the department in recovering the monies shall be borne by the borrower.

(b) Loans in default shall be referred to the state attorney general for collection and legal action if the department is not able to obtain payment.

If a loan should become delinquent, the following procedures will occur:

• Telephone contact will be made 10 days after due date.

• First notice of delinquent payment will be sent 15 days after due date.

• Second notice will be sent 30 days after due date.

• Third notice will be sent 60 days after due date.

• Fourth notice will be sent 75 days after due date. A certified, return receipt notice will be sent. During the first 75 days of delinquency, written and oral communication, as well as site visits, will be utilized to resolve the delinquency. Every effort will be made through personal contact to resolve the delinquency.

• After 90 days of delinquency, a loan due demand notice will be sent by legal counsel. If after 90 days a delinquency still exists, and the loan has not been renegotiated or brought current, the loan may be declared in default. DBEDT in consultation with the State Department of the Attorney General may immediately commence procedures to recover on borrower's security. No loan modification will be approved unless it can be demonstrated that modification will improve the borrower's ability to repay the loan. When the CBED RLF receives proceeds on a defaulted or written off loan priority of payments will be governed pursuant to 13 CFR §307.12 (c).

11.5 Write-Offs

Any decision to abandon further legal action on a defaulted loan because it has become not collectable will be made in consultation between DBEDT and the State Department of the Attorney General. IRS Form 1099C will be submitted to the borrower and to the IRS.

12. Administrative Procedures

12.1 New RLF's

The CBED RLF was created with an original appropriation of $900,000, in 1991. Sources of revenue for the CBED RLF since then have included repayments of loan principal, loan interest, "transfers" of general funds from DBEDT or funds appropriated by the State Legislature; and fees from community conferences and other events sponsored through the CBED Program. This will be the first use of a federal grant award to expand the CBED RLF. As noted below, EDA grant award and the state's match will be placed in a sub-account of the CBED RLF for ease of tracking and reporting. Since the local share and federal EDA share will be held in one separate sub-account this will ensure that the local share proportion to the federal funds is adequate for the grant.

12.2 Accounting

A separate sub-account within the CBED RLF will be created by DBEDT's Administrative Services Office (ASO) for this EDA grant and the state match. The State of Hawaii accounting system will allow DBEDT to keep separate all EDA and state matching funds and then track loans, repayments of principal and interest and administrative fees separate from the rest of the CBED RLF. The CBED RLF is held in a pooled-interest account administered by the State of Hawaii's Department of Budget and Finance.

12.3 Administrative Costs

DBEDT intends to use the CBED RLF income to cover eligible administrative costs associated with the grant. The anticipated maximum percentage of income to be used for expenses will be in compliance with EDA's allowed percentage. DBEDT will apply, track, and report the administrative costs in compliance with 13 CFR 307.

12.4 EDA Reporting

As per 13 CFR 307.14 CBED staff will complete and submit CBED Revolving Loan Fund semi-annual reports and Income and Expense Statements to the Economic Development Administration (EDA) as required. As part of this reporting DBEDT will certify to EDA that the CBED RLF is operating in accordance with the applicable CBED RLF Operational and Administrative Plan.

12.5 Audits

The EDA RLF funds are subject to an annual audit requirement and the full value of the RLF (outstanding loans and available cash) must be shown every year on the Recipient's Schedule of Federal Expenditures. If the dollar amount of the RLF qualifies the RLF as a major federal program, the Recipient must ensure that the auditor performs the required federal audit procedures per RLF Standard Terms and Conditions Part II.E.8.